Apart from the dangerous public policy of regarding groups in the community, political, social, or industrial, even the group of the whole, as above the law, and the injustice done in the instant case to the innocent victim of official carelessness, the theory relied upon by the court manifests a tendency to enlarge the scope of governmental immunity from suit and responsibility. This is directly opposed to that of the rest of the world and even to that found in our law of municipal corporations. It but indicates the need in this country of further legislative protection for the individual against the injuries inflicted upon him in the operation of the social enterprise known as the state.

E. M. B.

LIABILITY FOR PAYMENTS ON STOCK ISSUED FOR OVERVALUED PROPERTY OR FOR PROPERTY NOT LEGAL PAYMENT

Under modern statutes payment for the issue[1] of stock by a corporation is often expressly limited to money or property actually received, or labor done, other forms of payment being forbidden. Furthermore the property or labor must not be overvalued.[2] Some statutes also provide that no issue can be made until the stock is full-paid.[3] In cases where stock has been issued, or a contract made for its issue, in violation

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[1] The term "issue" in the phrase "issue of stock," as it is used in the cases, is metaphorical, and perhaps derived from the actual issue of certificates. The phrase "issue of stock" seems to be used by the courts to signify corporate recognition of a subscriber as owning a share, or proportional interest, in the capital assets of the corporation.

[2] The methods of determining sufficiency of value are outside the strict scope of this comment. One of two rules is usually used. The first is the true-value rule. This in effect is that the received property is sufficient to authorize a given issue of stock when the true value of the property is equal to the nominal value of the issue, or to the value authorized by charter to be received in return for the issue. For purposes of applying this rule, the value of the property seems to consist in its actual purchasing power in terms of dollars at the time of the transaction. The true-value rule was applied in *Tramp v. Marquesen, infra,* note 6; *Lavell v. Bullock, infra* note 15; *Detroit-Kentucky Coal Co. v. Bickett Coal and Coke Co., infra* note 10. The second method is the good-faith rule, which briefly is that the property is sufficient when the appraisal of its value, made in good faith by the directors of the corporation, is equal to the nominal value of the issue, or to the value authorized by charter to be received in return for the issue. This test of value substitutes for a determination of actual purchasing power an estimated purchasing power. *Caldwell v. Robinson* (1920) 179 N. C. 518, 103 S. E. 75; *Conley v. Hunt* (1920) 94 Conn. 551, 109 Atl. 887. The good faith rule was applied in *Scully v. Automobile Finance Co.,* and *Winters v. Lindsay, infra* note 5.

[3] Where a statute is of this kind, the issue of stock at a discount, payment being made in money, is analogous to an issue for overvalued property, and is so treated in this comment. The corporation accepts $20, and issues stock of $100 par value. It thus receives property worth only $20 and makes an issue that is only authorized to be made for $100.

of the provisions of such statutes, what is the position of the various parties involved in the transaction?

Take first the position of the corporation. The corporation may consist in just those persons who assented to the illegal issue. Or it may consist in those persons, plus other innocent shareholders who have paid full value for their shares. In the former case it seems clear that the corporation should have no remedy against the subscriber. In the latter case may these innocent shareholders, either in their own name or in that of the corporation, maintain an action to cancel the issue? It seems just that they should be able to do so. Both common law and statutes should be designed to give the maximum protection to innocent shareholders. Accordingly it is held that such an action may be maintained.[4] Some courts, however, do not permit cancellation when the defective contract is executed, regarding it as more just to consider the contract of issue as at least partially valid, and full payment of the shares enforceable.[5] This result seems somewhat hard on legally uninformed members of the public who have subscribed for stock issued for less than its nominal value. Perhaps those courts are fairer which hold that the defendant subscriber is not liable.[6] Where the subscriber is also a promoter, courts may be liberal in their remedy to the corporation,[7] and harsh to the subscriber.[8]

Another problem is presented in case the defendant is not a subscriber, but a subscriber's transferee. Of course if he is a transferee with notice, actual or constructive, of the true state of the transaction, he should be in no better position than his transferor, and such is one part of the holding in the recent case of *Bowen v. Imperial Theatres, Inc.* (1922, Del. Ch.) 115 Atl.918. But if he is an innocent purchaser of a certificate as for full-paid and non-assessable shares, the corporation should not be allowed to bring an action of any sort against him.[9] As

[4] *Frame v. Mahoney* (1920) 21 Ariz. 282, 187 Pac. 584, under Const. 1910, art. 14, sec. 6.

[5] *Scully v. Automobile Finance Co.* (1920, Del. Ch.) 109 Atl. 49, under Const. 1897, art. 9, sec. 3, and Rev. Code, 1915, ch. 65, secs. 1928 and 1934-1937; *Whitewater Tile & Brick Co. v. Johnson* (1920) 171 Wis. 82, 175 N. W. 786; *Winters v. Lindsay* (1921, Calif. App.) 198 Pac. 43 (hearing denied by Supreme Court).

[6] *Kanaman v. Gahagan* (1921, Tex.) 230 S. W. 141, under Rev. Sts. 1911, art. 1146, and Const. 1876, art. 12, sec. 6; *Tramp v. Marquesen* (1920) 188 Iowa, 968, 176 N. W. 977, under Supp. Code, 1913, secs. 1641 b, d, and f. The situation is altered when a creditor, and not the corporation, is plaintiff. See *infra* at p. 886.

[7] *Whitewater Tile & Brick Co. v. Johnson, supra* note 5. From the language of this case, however, it looks as though the same result would have been reached had the defendant been an ordinary subscriber rather than a promoter. The case was decided under Sts. 1898, ch. 85, sec. 1753, as amended by Laws, 1907, ch. 576, sec. 2.

[8] *Cahall v. Lofland* (1921, Del. Ch.) 114 Atl. 224, under Const. 1897, art. 9, sec. 3, and Rev. Code, 1915, ch. 65, sec. 1928.

[9] *Rhode v. Dock-Hop Co., infra* note 16; see *Lavell v. Bullock infra* note 15. Those were actions on behalf of creditors. *A fortiori* the defence would be good against the corporation.

between him and the shareholders of the corporation, the protection of the law should be on his side. There has usually been a greater degree of neglect on the part of the shareholders than on that of the *bona fide* transferee.

But suppose the position of the parties is reversed, and it is the corporation that is defendant. The subscriber may here, in the case of an unexecuted promise of the corporation to recognize him as a stockholder, be bringing an action to be recognized as such, that is, "to have stock issued" to him, or to obtain damages for failure to do so. In either of these cases judgment should be for the defendant.[10] The contract is illegal, and the public and the innocent shareholders are best served by not forcing the corporation to perform. If the subscriber has executed his part of the contract, and furnished property of real, though insufficient, value to the corporation, it seems equitable to let him have some remedy.[11] If the corporation has issued the stock, and the subscriber is resisting its cancellation, judgment again should be against the subscriber in cases where his payment has been nugatory. But here again if he has paid in overvalued property and is willing to pay further assessments, it would perhaps be best not to hold the transaction void, but to require that all certificates and records be made to show the exact state of the transaction.[12] If it is not the subscriber, but the subscriber's *bona fide* transferee, who is resisting cancellation of his shares, he should win, for the same reasons that he should not be liable to assessment.[13] Here again, however, those courts that consider the issue void could give the transferee no protection against cancellation, though perhaps there would be a remedy against the transferor who represented that the issue was full-paid. If the subscriber is seeking to cancel his own promissory notes, on the ground that they were illegal payment for the issue of stock, it is submitted that he should not be allowed to do so. But of course in those jurisdictions where the statutes are held to make an issue for illegal payment void, the cancellation of the notes will be permitted.[14]

[10] *Detroit-Kentucky Coal Co. v. Bickett Coal & Coke Co.* (1918, C. C. A. 6th) 251 Fed. 542, under Ky. Const. 1891, sec. 193, (suit by subscriber to compel specific performance); *Kirkup v. Anaconda Amusement Co.* (1921) 59 Mont. 469, 197 Pac. 1005, under Const. 1889, art. 15, sec. 10, and Rev. Code, 1907, sec. 3894, as amended by Laws, 1917, ch. 89 (action for damages for refusal to perform contract).

[11] *Brockway v. Ready Built House Co.* (1920) 95 Or. 386, 187 Pac. 1038. In this case it looks as though the remedy would have to be in a separate action. For the rule of stockholders' liability in Oregon, see Const. 1859, art. 11, sec. 3, as amended Nov. 5, 1912, and Olson's Or. Laws, 1920, tit. 43, ch. 3. sec. 7792.

[12] Cf. *Scully v. Automobile Finance Co., supra* note 5. In that case it was said that the records must be made to show what had actually been paid on the stock, and that the shares would be assessable for the purposes of the corporation.

[13] Discussed *infra* p. 886.

[14] *Pruett v. Cattlemen's Trust Co.* (1920, Tex. Com. of App.) 222 S. W. 533, under Rev. Sts. 1911, art. 1146, and Const. 1876, art. 12, sec. 6.

Take next the position of a creditor of the corporation, or one representing a creditor. A creditor-plaintiff at least stands in the shoes of the corporation as far as unpaid amounts upon shares are concerned, where the stock has been improperly issued for overvalued property, or for property not legal payment. The amount of any debts due the corporation in such a case should *a fortiori* be at the disposal of a *bona fide* creditor. It would seem just that, even in a jurisdiction which gave to the corporation no remedy of obtaining payment to the par value of the shares issued for improper consideration, the creditor should not be denied such remedy. A creditor can not be protected by cancellation of the shares; the remedy he wants is to have the stock full-paid in accordance with the corporate records. But in a jurisdiction that holds the issue *void,* the creditor is deprived of this remedy.[15]

If the creditor is acting not against a subscriber, but against a subscriber's transferee—provided he be not chargeable with actual or constructive notice of the true state of the transaction—an interesting issue is raised. Here both the creditor and the shareholder have acted in good faith. Which one should bear the loss with which both are threatened on account of their having trusted the representations of the corporation? Apparently the creditor must suffer.[16] He is perhaps more at fault than the transferee. Further he might properly be given a recovery against the officials of the corporation.[17] But so also, if the transferee were held liable, it would seem that he might recover against the transferor.

In any of these cases, in determining the wisdom of statutes or decisions, the criteria must be the protection of the public, the creditors, and the innocent shareholders. Certainly those jurisdictions which bluntly hold void the issue of stock for overvalued property, or for property that is not legal payment, do not in many situations seem to serve best the interest of any one of these three groups.

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[15] *Lavell v. Bullock* (1919, N. D.) 174 N. W. 764, under Const. 1889, art. 7, sec. 138, and Comp. Laws, 1913, secs. 4527, 4528; cf. *Terrell v. Warten* (1921, Ala.) 89 So. 297, under Const. 1901, art. 12, sec. 234.

[16] *Rhode v. Dock-Hop Co.* (1920, Calif.) 194 Pac. 11, under Civil Code, 1872, sec. 323, as amended by Sts. 1907, ch. 279, sec. 1; 12 A. L. R. 449, note.

[17] Cf. *Lavell v. Bullock, supra* note 15.